

Internal Revenue Service

Department of the Treasury

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Release copies to District

Washington, DC 20224

Date 8/30/93

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date: JUN 2 1993

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. For the reasons stated below, we conclude that you do not qualify for tax exemption under this section. Your protest rights are also explained below.

You were incorporated under the laws of the State of [REDACTED] on [REDACTED]. Your articles of incorporation, as amended, provide that you were formed for charitable and educational purposes.

Your sole activity is to solicit funds from businesses, organizations and individuals for scholarships which will be awarded as prizes to the top three finishers in the [REDACTED] pageant.

You state that you are a scholarship granting entity and do not conduct any pageant contests. You assert that the [REDACTED] is organized and conducted by [REDACTED]. However, you are subject to the rules and regulations of the state and national pageants. No grants will be awarded to persons who do not participate in and abide by the rules and regulations of the [REDACTED] contest.

The following are, in relevant part, the requirements to participate in the [REDACTED] pageant:

(1) Contestant must be at least 18 years of age and under 27 years of age;

(2) Contestant must be single, never have been married, divorced or had a marriage annulled;

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[REDACTED]

(3) Contestant must not be pregnant or ever given birth to a child;

(4) Contestant must not have participated in any previous national Miss USA Pageant or any other state pageant preliminary to the Miss USA Pageant this year;

(5) Contestant must be a citizen of the United States and have resided in the state for at least six months;

(6) Contestant must agree that if selected to represent [REDACTED] in the Miss USA Pageant she will participate in that pageant and abide by all rules and regulations. If she wins the Miss USA Pageant, she must agree to participate in the Miss Universe Pageant and abide by the rules and regulations governing that pageant;

(7) Runner-up contestant in the Miss USA Pageant must agree to participate in any other pageant to which Miss Universe, Inc. sends a delegate and abide by its rules and regulations;

(8) Contestant agrees that if she wins or succeeds to the state title or the title Miss USA, then she will not participate in any pageants during the time that she holds either of those titles, unless authorized in writing by Miss Universe, Inc. and;

(9) Contestant releases, unconditionally and forever, any claim against Miss Universe, Inc., or its officers, directors, employees, agents, subsidiaries, assigns or corporate parents, which she has by virtue of participation in this pageant or any use of her name, likeness, voice, and/or biography in connection with this pageant, including use in promotional material.

According to the Official Judges Handbook for the [REDACTED], contestants are judged in three categories: personal interview; evening gown; and swimsuit competitions. The judges' rules state that in the personal interviews with each delegate, the judges should seek out a young woman who, among other things, is willing and able to cope with the pressures and responsibilities of her new fame and duties; will not be frightened by change and is open to new people, places, and experiences; is secure enough to spend long periods of time away from family and friends; and has the stamina to perform under a very demanding schedule.

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You state in a letter dated [REDACTED] that the winner of the [REDACTED] Pageant would be expected to appear at other programs in [REDACTED] which are affiliated with the program, such as [REDACTED], [REDACTED], [REDACTED], and [REDACTED].

The winner might also be asked to participate at charity functions, speak to civic clubs or high school or college student assemblies and to represent the program at various business openings. However, you note that the scholarship that the winner receives will be totally independent of her willingness to make any public appearance.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for educational or charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Rul. 66-103, 1966-1 C.B. 134, holds that an organization whose primary activity is to provide awards and grants, including scholarship and fellowship grants to needy

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individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in a charitable activity of providing relief of the poor.

Rev. Rul. 68-20, 1968-1 C.B. 55, concludes that amounts paid to participants in a beauty contest as "scholarships" are compensation for services rendered and are not excludable from gross income as scholarship or fellowship grants.

Rev. Rul. 69-257, 1969-1 C.B. 151, holds that an organization providing scholarships selected from a broad class of applicants on the basis of scholastic standing, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in the charitable activity of advancing education.

Section 117(a) of the Code provides, in relevant part, that gross income does not include any amount received as a qualified scholarship.

Section 117(c) imposes a limitation thereon, however, and specifies that the exclusion for "qualified scholarships" shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship.

A scholarship or fellowship grant represents payment for services when the grantor requires the recipient to perform services in return for the granting of the scholarship or fellowship. A requirement that the recipient pursue studies, research or other activities primarily for the benefit of the grantor is treated as a requirement to perform services. A scholarship or fellowship grant conditioned upon either past, present, or future services by the recipient, or upon services that are subject to the direction or supervision of the grantor, represents payment for services under this section.

In Bingler v. Johnson, 394 U.S. 741, 751 (1969), the Supreme Court stated that to be excluded from gross income under section 117, scholarships must be "relatively disinterested, 'no strings educational grants, with no requirements of any substantial quid pro quo from the recipients."

Miss Georgia Scholarship Fund, Inc. v. Commissioner of Internal Revenue, 72 T.C. 267, (1979), involves an organization formed for the purpose of giving scholarships to contestants in

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the Miss Georgia Pageant. The participants were required as a condition for qualifying for scholarships to enter into a contract which would obligate them in the event they were selected to participate in the Miss America Pageant to abide the rules and regulations of the pageants, including participation in public appearances and the like, under the sponsorship of Miss Georgia Pageant. These scholarships are not available to those contestants who fail to execute the contestant contract.

The Tax Court held that the "scholarship" grant is compensatory in nature, i.e., payment for the contestant's agreement to perform the requirements of the contestant's contract, and not a scholarship within the meaning of section 117. Therefore, the petitioner was found not to be organized and operated for any of the purposes described in section 501(c)(3) because it was organized to give compensatory payments and to further the interests of an organization that was not exempt under section 501(c)(3).

You provide monetary payments to contestant winners. There is nothing in the agreements which you supplied that requires that these payments be used for the furtherance of education.

However, to the extent the payments are used for education, the same issue which was presented to the Tax Court in Miss Georgia Scholarship Fund, Inc., supra, is present in your case. Therefore, we must determine whether the scholarships you award to contestants in the [REDACTED] Pageant are compensatory payments as defined in section 117-(c) of the Code, and thus not excludable from income pursuant to section 117(a).

The information submitted indicates that the winner of the [REDACTED] pageant is required to perform certain services and refrain from entering into certain contractual obligations. Although you state that no contestant is required to perform any services as a condition of receiving the scholarship, you contradict this by stating that the winner is expected to make public appearances. Additionally, the judges are looking for, among other things, qualities in the winner which would enable her to render certain services. The contracts that each contestant is required to execute merely confirm that each contestant is expected to render services by participating in the series of events leading up to the selection of [REDACTED]. Therefore, we conclude that the "scholarships" awarded are clearly payments for past, present and future services by the contestants. There is no requirement in section 117(c) of the Code that the services

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required of a grant recipient be performed directly for, or as an employee of, the grantor organization. Your "scholarship" awards are simply additional prizes for executing contracts, and for entering, participating in, and winning the [REDACTED] contests.

Therefore, the scholarships you award to contestants in the [REDACTED] are not excludable from the gross incomes of recipients under section 117(a) because the scholarships are described in section 117(c), and represent payment for services that are required of the recipients as a condition to receiving the scholarships.

Because your primary activity is the provision of compensatory payments to contestants in the pageant, you are not operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code pursuant to section 1.501(c)(3)-1(c)(1) of the regulations. Furthermore, by engaging primarily in the activity of providing compensation to contestants who are obligated to perform certain services for you, you are serving private rather than public interests contrary to section 1.501(c)(3)-1(d)(ii) of the regulations.

In addition, we find that there are significant similarities to distinguish your program from the exempt scholarship programs described in Rev. Ruls. 66-103 and 69-257, supra. In Rev. Rul. 66-103 exemption was based on the fact that the awards were given to needy individuals. Financial need is not a factor in your selection process. In Rev. Rul. 69-257, the basis for the granting of the scholarships was scholastic achievement. Although on your Form 1023 you state that you will obtain transcripts of those receiving grants and will monitor the progress of grantees, you do not require contestants to submit transcripts or provide any other evidence of scholastic achievement. Thus, you are not similar to either of the organizations described in Rev. Ruls. 66-103 and 69-257.

Accordingly, you do not qualify for tax exempt status under section 501(c)(3) of the Code. Therefore, contributions to you are not deductible under section 170 of the Code. You are required to file federal income tax returns on Form 1120.

A scholarship or fellowship grant that represents payment for services under section 117(c) of the Code is considered "wages" for purposes of section 3401(a). Additionally, the grantor of such amounts is subject to certain filing and or reporting requirements respecting wages. See Notice 87-31, 1987-1 C.B. 475, a copy of which is enclosed.

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You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. When sending a protest or other correspondence with respect to this case, you will expedite its receipt by placing the following symbols on the envelope: [REDACTED]. These symbols do not refer to your case, but rather to its location.

You also have the right to a conference in this office after your statement is submitted. If you desire a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Atlanta, Georgia which is your key district for exempt organization matters. Thereafter, any questions about your federal income tax status should be addressed to your key District Director. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely,

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
Rulings Branch 4

4/22/00

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cc: DD, Atlanta
Attn: EO Group

cc: State Officials

cc:

5/28/93

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